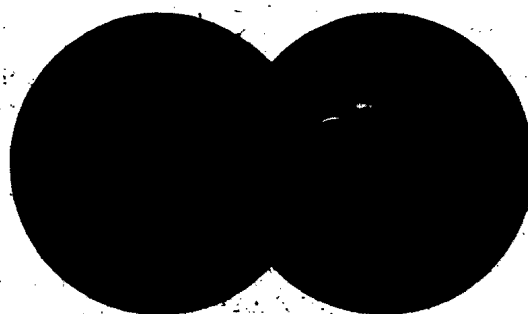


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WEEKLY SUMMARY



Number 3

Document No. 001
NO CHANGE in Class. ☐
☒ DECLASSIFIED
Class. CHANGED TO: TS S
Auth: DDA Memo, 4 Apr 77
Date: 31/01/78 By: 021
DDA REG. 77/1763

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SECRET**H I G H L I G H T S**

The mounting storm of public protest in France against Foreign Minister Bidault's acquiescence to the US-UK position on a government for western Germany, Arab and Jewish acceptance in principle of a UN cease-fire formula, the British policy shift regarding Palestine, and the developing Soviet economic offensive in Southeast Asia were the developments which assumed particular prominence during the past week.

The majority of the French people and their press have been highly vocal in expressing alarm at what they suppose to be the possible consequences of the establishment of a separate government for western Germany under US, British, and French auspices. It appears likely, however, that after the members of the French Assembly have had their opportunity to enunciate the traditional French apprehensions regarding a revival of German nationalism and certain current fears that the USSR might retaliate with force against the proposed western power action, the Assembly will endorse the agreements reached at London (see page 4).

Premier Schuman's government also is being plagued by several thorny questions of a purely domestic nature, which for the moment at least threaten the unity and stability of the "third-force" coalition. In Germany, an expected third-quarter coal deficit, the virtual exhaustion of the bizonal dollar fund for imports, and the recent wave of strikes threaten the achievement of industrial production goals for the US-UK Zones (see page 6). In Italy, De Gasperi's new "third-force" Cabinet has been presented with a knotty problem by the proposal of the USSR that Italy undertake a large and remunerative shipbuilding program for the Soviet Union.

The USSR, on the other hand, has been handed a temporary setback in Hungary by the Catholic Church. Communist plans to nationalize Hungarian church schools have been shelved for the moment following a violent public response to a strong pastoral letter threatening excommunication for those Catholics who supported nationalization (see page 8).

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A possible shift in Soviet-Satellite tactics regarding Greece is suggested by cautious Satellite peace feelers. If these are any indication, the Kremlin may have decided to abandon the military phase of the program for Communist domination of Greece in favor of more indirect procedures (see page 11).

An early cessation of hostilities in Palestine still does not appear likely, despite the fact that the Jews and the Arabs now have agreed in principle to a UN-proposed cease-fire arrangement. The main stumbling blocks to peace are the divergent views regarding admission of military-age immigrants and the reopening of the Jewish supply line to Jerusalem (see page 9). A modification in British policy, placing the UK in a somewhat more neutral position in the struggle, has resulted in suspension of UK arms shipments to Arab states and the withdrawal from Palestine of British officers assigned to the Arab Legion (see page 11). The prospects for more concerted action by the US and UK in seeking a settlement have been correspondingly improved.

In Southeast Asia, while continuing to push forward its propaganda and political offensives, the USSR has launched operations on the economic front. The Kremlin has followed up the establishment of a Soviet Legation in Bangkok with a proposed exchange of diplomatic representatives with the Indonesian Republic. These diplomatic maneuvers have come simultaneously with specific Soviet offers to exchange industrial items for certain raw materials (see page 14). Meanwhile, the Communist military forces have launched their long-expected offensive in Manchuria. (South China is the only practicable area on the Asiatic mainland to which the Nationalists could withdraw; limitations of this area as an anti-Communist base are discussed on page i.)

Western Hemisphere solidarity has been significantly impaired by Latin American purchases of military equipment manufactured outside the hemisphere and by the rebel victory in Costa Rica with its effect on the balance of power in the Caribbean (see page 18).

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WESTERN EUROPE

UNITED KINGDOM

Despite the surface unanimity of the British Labor Party during its recent conference, a serious conflict could develop within the Party over the issue of industrial nationalizations. It now appears that the rank and file at the Labor Party conference dutifully and respectfully endorsed the "go-slow" program of the Party leaders but actually reserved their real enthusiasm for the left-wing speakers who held out for industrial nationalizations at the previous pace. Moreover, in electing the Party's National Executive, the rank-and-file delegates displayed their preference for leftist candidates. In these below-the-surface manifestations, a potential revolt against the present moderate leadership exists. The incipient dissident movement could become particularly serious if an important and popular Laborite should take over its leadership.

Rising raw material prices continue to hamper Britain's dogged struggle to narrow the gap between exports and imports. The trade deficit for the first third of 1948 is considerably more than the Government had anticipated for the first half. The UK trade deficit for April, largely caused by the record cost of imports for that month, was the largest monthly deficit since September 1947. British Treasury officials have taken extraordinary pains to minimize the alarm caused by these trade figures. Nevertheless, the record of the past four months indicates that the British will not achieve an over-all balance of payments, which was the 1948 objective set by the Government less than three months ago. This failure will occur despite rising British production and an increasing volume of exports.

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SECRET**FRANCE**

The expected storm of public protest over the Bidault Government's acquiescence in the US-UK position on a provisional government for western Germany is reaching serious proportions. The majority of the Paris press is lambasting Bidault and his Cabinet for sacrificing French security. Many Frenchmen seem obsessed with the fear that the establishment of a west-German regime can only lead to Soviet military action which defenseless France will have to brave alone. There is also a mounting feeling among the French that the present Government cannot survive the forthcoming Assembly debates on the German program. These debates undoubtedly will prove as heated as the growing public protest. They will clearly reflect the basic French apprehensions that: (1) the election of a constituent assembly, as proposed, will lead to a revival of German nationalism and a renewed threat to France's existence; and (2) the establishment of a trizonal government might provoke such a serious Soviet military threat that French security could only be protected by a US military guarantee. In the last analysis, however, the Assembly will probably endorse the agreements reached at London, because the French assume that the US and UK will proceed independently if France fails to participate. French jitters may be calmed by the concessions already made by the US and UK regarding western European security and the International Authority for the Ruhr.

Several domestic issues also threaten the stability and unity of Premier Schuman's "third force" coalition. Chief sources of danger to the Government lie in the Socialist opposition to the proposed procedure for eliminating, as an economy measure, some 150,000 civil servants and in the differences between the Catholic MRP (Popular Republicans) and the traditionally anti-clerical Socialists regarding subsidies to religious schools. No matter how successfully these issues may be resolved in the Cabinet, they will probably provoke heated partisan debate in the Assembly in anticipation of the

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FRANCE

fall elections. On the other hand, the Cabinet's position will be strengthened by the better food situation, the prospects of a good grain harvest, and the prevailing popular belief that the present government, if it is spared political crises, may well be able to achieve economic rehabilitation.

ITALY

The recent Soviet proposal that Italy undertake a large shipbuilding program for the USSR has presented the Italian Government with a knotty problem. Shipbuilding, Italy's third largest industry, is vital to Italy's economic recovery. Italian officials consequently believe that the increased employment and dollar revenue from such a program would be significant economic benefits. Premier De Gasperi, however, will be reluctant to give the Italian Communists an opportunity to propagandize the benefits of commercial relations with the USSR and thereby regain some of the prestige lost in the last elections. Also, the Government is hesitant to make financial commitments which might siphon off European recovery program benefits to a non-participant in the program or which the USSR might choose to construe as reparations. Nevertheless, the Italian Government would appear to incur less risk from Communist propaganda which plays on the theme of a benevolent USSR than from Communist allegations that Italy, as a tool of western imperialism, is not allowed to trade with the east regardless of the benefits to its economy.

In competing with the Communists for labor's support, the centrist and moderate leftist groupings within the Italian Cabinet will be obliged to act in concert or risk weakening the new "third force" coalition and turning labor to the extreme Right or Left. In a concrete effort to outstrip Communist appeals for worker support, the Christian Democrats have advanced their own plan for promoting such tangible laboring-class benefits as low-cost housing. There is a suggestion that the Christian Democrats may attempt to press their plan

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ITALY

independently in an apparent desire to win over labor supporters of the moderate Socialists. The Christian Democrats clearly will defeat their own ends, if they enter into competition with the moderate Socialists and fail to develop an integrated program. Such rivalry would encourage Left-Right division within each group, block implementation of an effective program by the coalition Government, and impede concerted efforts of the moderates to check Communist domination of the Italian General Confederation of Labor.

GERMANY

Industrial production goals in western Germany may be missed because of an expected $3\frac{1}{2}$ million ton coal deficit in the third quarter of 1948, the virtual exhaustion of the bizonal dollar fund for imports, and the recent wave of strikes. coal allocations to essential German industries, including steel, are to be cut 16%. Ruhr coal production, which currently averages between 260,000 and 265,000 tons per day, is not expected to improve very much until the next incentive program goes into effect in July, and even then the improvement will probably be temporary. Unless the impending coal deficit is cut by imports or reduced exports to other European countries, a reduction in industrial output appears inevitable. Exhaustion of the bizonal dollar fund would curtail production by stemming the flow of raw materials from abroad; this possibility has been temporarily averted by the Joint Export-Import Agency which has opened credits for \$153 million in foreign banks. Production may also be adversely affected by more determined action on the part of discontented workers. The latest strikes, in protest against unsatisfactory food conditions, were of longer duration than any previous strikes. Workers who up to this time had confined themselves to 24-hour demonstrations, involving slight loss of man-hours, maintained the most recent strikes until demands for increased rations were met. Unless the food situation materially improves, slow-downs may begin to appear in many factories.

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SECRET**GERMANY**

The USSR apparently plans to impose postal censorship in Berlin in a new move to extend Soviet control over the city. Already the Reichspost on Soviet orders is arbitrarily delaying mail from Berlin addressed to the western zones and US-UK authorities are considering retaliatory steps. Soviet authorities who now claim the right to inspect parcel post shipments could apply such inspection to letter mail as well because all mail to the west must pass through the Soviet Zone.

AUSTRIA

The indefinite suspension of the Austrian treaty talks brought no serious repercussions either from the Austrian Government or from the general public, both of which supported the western stand against Yugoslav territorial claims. Surprisingly enough, Soviet representatives in Austria did not return to their customary belligerence, but even extended their recently adopted amiability. Officially, the Austrian Government felt obliged to express regret at the suspension of the treaty discussions, to broach to the US and the UK the possibility of bringing the treaty question before the UN, and to address a note to the USSR requesting a renunciation of the Yugoslav claims and reaffirmation of Austria's territorial integrity. The Government, additionally, took the opportunity to protest against continued payment of occupation costs in emphasis of its disappointment over the prospects of an indefinite prolongation of the occupation. These governmental moves, however, appeared motivated by the desire to publicize Austria's position rather than by any belief that concrete action would result.

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SECRET**E A S T E R N E U R O P E**

A request by the joint Soviet-Hungarian shipping company for permission to send three barges up the Danube to Passau is probably a Soviet attempt to sound out, prior to the 30 July International Danube Conference, the US attitude concerning the resumption of east-west Danubian shipping. (The US has prevented Soviet and Satellite vessels from entering its zones in Austria and Germany in retaliation for repeated Soviet refusals to permit western shipping to enter the Soviet sector of the Danube.) In an attempt to gain access to the western Danube, the USSR may make substantial concessions to US-UK demands at the forthcoming conference, but these "paper" concessions can easily be nullified by Soviet manipulation of Satellite port facilities and shipping fleets. Thus, any real change in the policy of the USSR toward the west will not be revealed by concessions at the conference, but only by Soviet cooperation, after the conference, in opening the Danube to all shipping on equal terms.

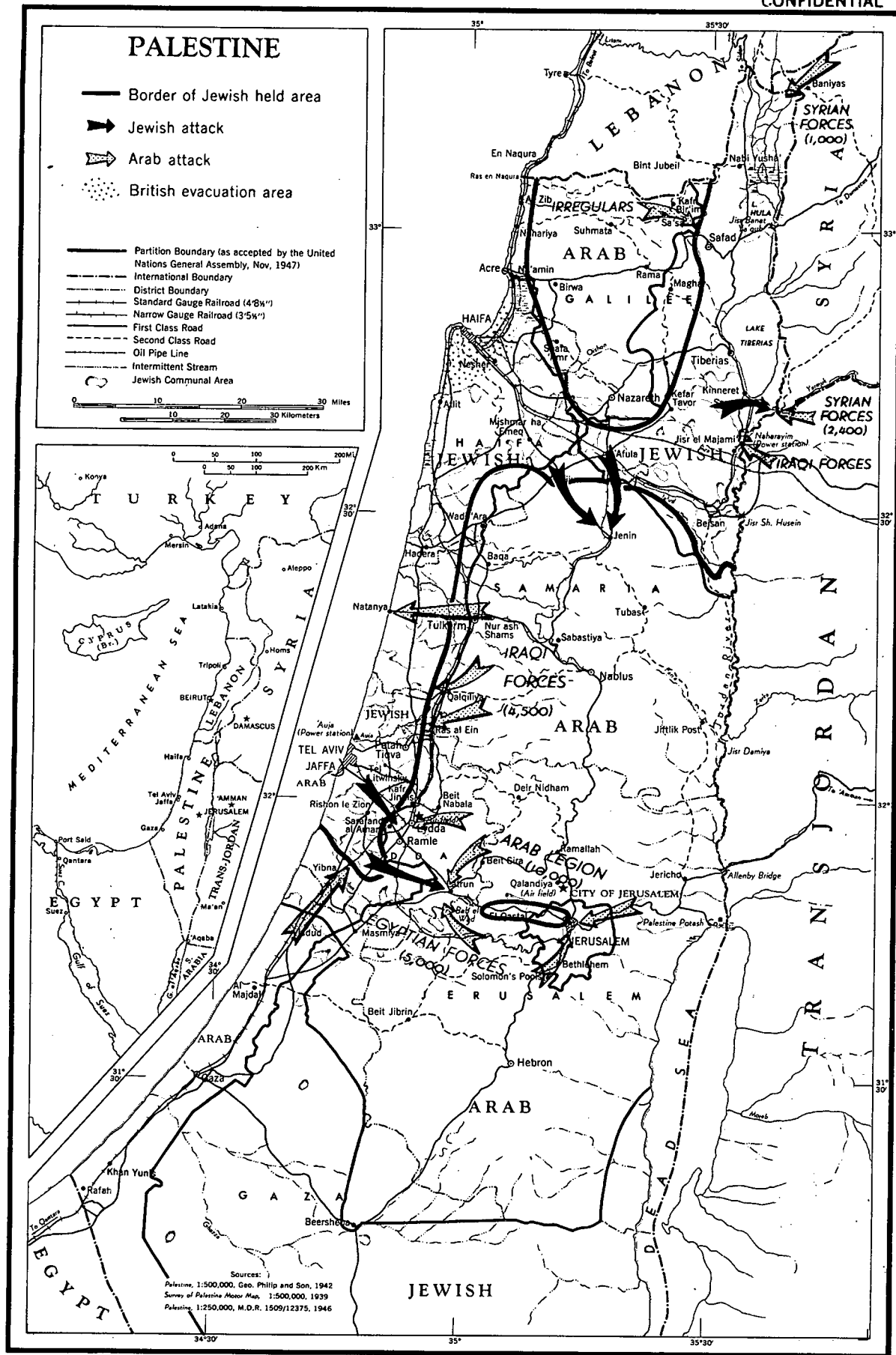
HUNGARY

The nationalization of Hungarian church schools has been delayed by determined resistance of the Catholic Church to the Communist plan. The Cabinet delayed its nationalization plans as a result of the violent public response to a surprisingly strong pastoral letter threatening all Catholic supporters of the proposed school nationalization with excommunication. (Ironically, the letter was read in one city by mistake a week ahead of the Cabinet's scheduled announcement rather than following.) Besides announcing its willingness to negotiate on the nationalization issue, the Cabinet agreed to retain religious teachers and compulsory training in the schools. As a result of this incident, Cardinal Mindzenty has unified all Hungarian Catholics under his leadership and also has obtained the active support of a majority of the Protestants. The Catholics are prolonging the present negotiations as long as possible and may make a public statement to the US, the UK, and the USSR, accusing the Hungarian Government of violating the human rights clause of the peace treaty. Such determined Catholic resistance will probably force the Communists to abandon their frontal attack in favor of more indirect methods.

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SECRET**NEAR EAST - AFRICA****PALESTINE**

Although Jews and Arabs have accepted a cease-fire in principle, early agreement on the conditions for a cessation of hostilities is improbable. There is considerable disparity between the belligerents on the questions of the admission of immigrants of military age to Palestine during the period of the truce and on the reopening of a Jewish supply line to Jerusalem. Moreover, much acrimonious debate may be anticipated in the Security Council before these and other problems can be solved to the satisfaction of both parties. Even if agreement is finally reached, the truce will be an uneasy one, punctuated by accusations of violation by each side and by desultory fighting.

The chance is remote that during the four-week period of the truce a basis for a permanent settlement of the Palestine problem can be established. Both sides are as uncompromising as ever on fundamental issues. The Arabs refuse to concede the possibility of a sovereign and independent Jewish state with freedom of immigration, which is the foundation of Jewish demands. One hope of a solution appears to lie in the coordination of US and UK policy to put pressure on Jews and Arabs to accept a nominally federal state in which the Jewish areas would be autonomous and to which the Arabs would permit a substantial degree of immigration. Failing such a solution, an indefinite continuation of strife in Palestine and unrest throughout the Middle East appear to be inevitable.

Military operations in Palestine have become concentrated in three areas: (1) Jerusalem and its vital supply road from Tel Aviv; (2) the environs of Tel Aviv; and (3) the Arab-held triangle north of Nablus. In the battle for Jerusalem, the emphasis has shifted from the city itself to its supply line. Arab Legion troops have followed up their capture of the Old City by closing in on the strongly entrenched Jewish forces in the New City, but the main effort of both sides is now being made around Latrun and in the Lydda-Ramle area (along the supply road), where the Arabs have so far succeeded in preventing a Jewish breakthrough. At the same time, other Arab forces advancing

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SECRET**PALESTINE**

on Tel Aviv are about 10 miles from the Israeli capital. Iraqi units have recaptured Ras el Ein, the Jerusalem water supply station northeast of Tel Aviv, while other Iraqi troops are reported to have driven through to the coast north of Tel Aviv. Egyptian columns advancing from the south are reported at Yibna, a few miles south of the Lydda-Ramle battlefield. Jewish operations have consisted mainly of counterattacks in the Tel Aviv-Jerusalem sector. However, Hagana forces attacking from the north have already reached the neighborhood of Jenin, at the northern tip of the triangular Arab stronghold in north-central Palestine. If continued, this offensive against the principal Arab supply base might force the diversion of Arab troops from central Palestine and thus relieve the pressure on Tel Aviv.

Arab nationalist reaction in French North Africa to the current situation in Palestine apparently is following the pattern set by the Arab response to the UN vote on Palestine partition in November 1947. Although the Arabs in North Africa were disagreeably surprised by US recognition of Israel and would resent any formal acknowledgment by France of the new Jewish state, the present Arab feeling against the Jews in Morocco, Algeria, and Tunisia will gradually subside unless the Palestine situation becomes greatly amplified in scope. Arab protestations against the present turn of events in Palestine will probably continue not to go beyond the boycott of Jewish shops, angry oral criticism in the market places, and inflammatory comment in the Arab language press. The extremely volatile nature of the Arabs must always be borne in mind, however, and, in spite of the counsel for moderation now being offered by such nationalist leaders as the Neo-Destourian Salah-Ben-Youssef in Tunis and the Sultan of Morocco himself, an explosion is always possible. Without outside interference, Moslem-Jewish relations in North Africa will probably remain undisturbed, and Arab and Jew will probably continue to live in relative harmony as they have done for centuries.

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SECRET**PALESTINE**

Spain may be secretly furnishing the Arabs with munitions. Although the amount and the quality of materiel which could be obtained from any Spanish source would be insignificant, delivery of a few arms as a gesture of friendship would be in accord with Spanish policy to improve relations with the Arab world.

Because of the mutual French and Spanish interest in Morocco, the Spanish Government has suggested that the two governments coordinate their policy concerning future recognition of Israel. Through such coordination, the Spanish probably hope that they could delay French recognition if the French should be disposed to accord it. Spain is loathe to recognize the Jewish state lest recognition incite anti-Spanish acts by Moroccan nationalists and lead to another uprising against Spain. There are no pressures within Spain for recognition: Spain has no Jewish population, and the Jews under Spanish rule--residents of the Spanish Protectorate in Morocco--number only a few thousand.

A modification of British policy regarding Palestine is indicated by the announced UK decisions: (1) to withdraw from Palestine the 21 officers and 5 men assigned by the War Office to the Arab Legion; (2) to reconsider payment of the 12 July installment of the subsidy to the Legion in the light of a forthcoming UN decision; and (3) to suspend arms shipments under treaty obligations to Middle East countries for the duration of any truce resulting from a cease-fire agreement. This expected change in policy is attributable to a realization that over-all US-UK collaboration was being jeopardized by a widening rift between the two powers, to the rapidly increasing public criticism of Britain's moral position, and to reported dissatisfaction in the Cabinet with Bevin's Palestine policy.

GREECE

Cautious Satellite-guerrilla peace feelers may be observed in certain recent developments. A Bulgarian official suggested to a Swiss diplomat that the Bulgarian Government might consider resuming normal relations with the "monarcho-fascist" government in Athens. The Yugoslav delegate at the UN

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SECRET**GREECE**

has reportedly been discussing the Greek situation in a relatively conciliatory tone. An Albanian note to the Secretary General of the UN, although couched in the usual vituperative terms, suggests that it is possible for Greece to settle its differences amicably with Albania. On 1 June the radio of the guerrilla army broadcast a declaration that the "democratic" government is "always ready to accept and encourage any initiative coming from anywhere" which would "lead to peace."

These developments and the continuing failure of the Satellites to furnish significant aid to the guerrillas suggest that the Kremlin may have decided to abandon the military phase of the Communist program in Greece. If so, guerrilla leaders may well be seeking a formula for ending hostilities without prejudicing the ultimate Communist objective of taking over Greece. The Greek Government, which is aware of such a danger, is not likely to come to terms with the guerrillas. If, however, Communist leaders are able to get political concessions from the Greek Government before the Greek National Army has achieved an absolute victory, the morale of non-Communist Greeks will be impaired and the hard core of the Greek Communist Party will be left intact. Such a situation would eventually expose an unstable Greece to the familiar, dreary round of Communist political obstruction, blackmail, and economic strangulation, and would result finally in a total Communist victory.

IRAN

While Prime Minister Hakimi continues to astonish Tehran political circles by his ability to remain in office without visible means of support, parliamentary or otherwise, his would-be successors are frantically jockeying for position. The USSR (which has just engaged in a sharp exchange of notes with Iran over a border incident) is reportedly backing two such candidates, and it is barely possible that a prime minister more responsive to Soviet handling might take office in the confusion which would attend Hakimi's fall. However, former Prime Minister Qavam remains the most likely candidate for the job, and unless Qavam is unable to arrive at any sort of modus vivendi with the Shah, a rival is not likely to obtain the premiership.

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SOUTH AFRICA

Sudden changes in South African foreign policy appear unlikely, although the unexpected defeat of General Smuts by the extreme-rightist Nationalist-Afrikaner coalition represents a considerable victory for South African isolationists. The implications of the election for Commonwealth solidarity are not good because the new government of Prime Minister Malan is not likely to encourage such policies as cooperation in Empire defense or immigration from the UK. Despite the fact that South Africa has, in the past, acted quite independently of the UK in political matters, enlightened self-interest will probably dictate continued cooperation in economic affairs.

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SECRET**F A R E A S T**

A Soviet economic offensive in Southeast Asia to match the Soviet propaganda and political offensive in that area has become increasingly evident since the recent opening of a Soviet legation in Bangkok. The recent actions of the USSR indicate a Soviet realization that any successful political-propaganda offensive requires accompanying economic action. Specific Soviet offers have been made to exchange industrial items for certain Southeast Asia raw materials at prices highly competitive with those of the US and the UK. The USSR has also indicated that it will offer large quantities of textiles soon. These offers may spring, in part, from the Soviet desire to obstruct as much as possible the US program for expanding Japanese exports and imports. The few transactions which have thus far been completed indicate a determined attempt to penetrate the Southeast Asia economy. Such commercial activities offer the USSR the advantage of economic penetration combined with an access to rubber and other strategic products in this area. Reported large rubber purchases in Southeast Asia by the USSR fit into the pattern of this Soviet economic offensive. These large purchases of rubber also indicate that the Soviet Union is stockpiling this strategic commodity. Soviet concern over its rubber supply is shown by: (1) the speed with which it has placed sizeable orders; (2) the placing of orders for medium and low-grade rubber at top-grade prices when top-grade is not available; and (3) an insistence upon special packaging which will permit preservation for 8-10 years. At the current buying rate--55,000 tons for February and March--Soviet purchases for 1948 will total several times last year's import of 46,000 tons. Because the USSR imported only 32,000 tons in 1941, the present accelerated rubber purchasing program seems to be a stockpiling maneuver.

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CHINA

Growing Chinese student opposition to US policy in Japan, partly spontaneous and partly exploited by Communist and other dissident elements to embarrass the National Government, may be used to channel traditional Chinese anti-foreign feeling into a specific antagonism toward US policies. Heretofore, most Chinese criticism of US policy in Japan has originated in the press, with the National Government giving outward and official support to the US policy. The Chinese students, who since the end of the war have frequently expressed their opposition to various Government policies through strikes and riots, now are focusing attention on US policy in Japan in demonstrations which began recently in Shanghai and spread rapidly to Peiping.

The Communists have opened their long-expected Manchurian offensive by launching an attack upon Changchun, an isolated Nationalist garrison in central Manchuria. The attack, largely diversionary, was undertaken at the same time that additional Communist units were moving westward to the Chinchou area, where the main attacks are still expected. Communist successes were reported in neighboring Jehol Province where Communist forces occupied Lunghua and Pingchuan, north and east, respectively, of the beleaguered provincial capital, Chengteh. In Shantung, Communist units under Chen Yi are recrossing the Yellow River and have already cut the Tsinan-Pukou railroad at Taian, while Lui Po-cheng's forces are apparently driving eastward across the Peiping-Hankow railroad toward a rendezvous with Chen in northeast Honan.

AUSTRALIA

The major upset sustained by Australia's Labor Government on the domestic issue of adopting permanent rent and price controls provides further evidence of the Government's

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SECRET**AUSTRALIA**

declining prestige and its probable defeat in the 1949 elections. The opposition based its campaign on the grounds that the Commonwealth's temporary powers over prices and rents were adequate to deal with the present economic situation and that permanent legislation would only further the Labor Party's socialization program. The State Governments, both Liberal and Labor, claimed that price and rent controls should be vested in the States while public opinion was against the extension of federal controls at this time.

INDONESIA

A Dutch government more inclined toward a settlement by force in Indonesia is expected to emerge from the forthcoming 7 July elections in the Netherlands. The rightist Catholic Party is expected to make important gains and to dominate a Catholic-Socialist coalition. The prospects for a "stronger" policy in Indonesia are increased by: (1) the reaction of Dutch anti-Communists to Soviet establishment of diplomatic relations with the Indonesian Republic; (2) public lack of faith in the Security Council's ability to solve the Indonesian problem; (3) increasing resentment toward what is regarded as US interference in the issue and toward the US decision to withhold a loan for the Netherlands East Indies pending a political settlement; and (4) the prevailing belief that the Republic is a weak, nationalist movement. The Netherlands Government probably hopes to postpone any real decision in Indonesia until after the July elections.

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WESTERN HEMISPHERE

US plans for hemisphere defense have received a decided setback in Latin America, especially in Argentina, as a consequence of the purchase of aircraft and military equipment from abroad. The purchase in Latin America of equipment manufactured outside the western hemisphere produces an immediate and adverse effect upon US industry. The purchase of 100 jet aircraft which Argentina bought from England would probably have insured six months operation in an American factory. In addition, the arms standardization program has been indefinitely delayed, unless the program is expanded to include British production, because a British manufactured aircraft is now reported to be the standard fighter of the Argentine Air Force. Moreover, extra-hemisphere influence is further apparent in Latin America in the exchange of Argentine and British personnel as trainees and industrial technicians for jet aircraft. Other Latin American countries, specifically Venezuela, have shown an interest in purchasing British postwar aircraft, presumably as the result of the difficulty of obtaining them from the US.

MEXICO

Mexico's finances are in a critical condition as the result of dwindling US-dollar reserves and the rapid depletion of the US stabilization loan of \$50 million. Until July 1947, when Mexico placed severe restrictions on imports, Mexican reserves of US dollars were being expended at the rate of \$10 million per month. Smuggling and the corruption of Mexican officials in granting import permits have, moreover, considerably nullified the Government's efforts to enforce restrictions on imports. If Mexico makes the payments due the Export-Import Bank and those due for agrarian and oil claims, the government's financial difficulties will be increased. This would be especially so, if added to these, there should be a European settlement of the direct debt of the Mexican Government as well as a settlement of railway bond issues. Mexico's financial

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SECRET**MEXICO**

predicament can therefore be regarded as a more or less permanent dilemma unless the Government takes steps: (1) to redress its balance of international payments; (2) to encourage and protect foreign investments; and (3) to increase Mexican production for export.

COSTA RICA

The rebel victory in Costa Rica has accentuated the rivalries existing between the two balance-of-power groups in the Caribbean and has further impaired the US concept of hemisphere defense. Guatemalan assistance to the rebels has placed Costa Rica in the Guatemalan-Venezuelan-Cuban-Haitian axis. Reports exist of an international brigade on Costa Rican territory organized for the purpose of overthrowing the Carias government in Honduras and the Somoza regime in Nicaragua, with participants from last summer's unsuccessful invasion of the Dominican Republic active in the brigade. Somoza, Carias, and Trujillo have reportedly formed a defensive alliance for joint action in the event of an attack on any of their countries. The Nicaraguan Government is apparently permitting the organization on its territory of a Costa Rican counterrevolutionary force, while the acquisition of armaments, especially airplanes, continues.

PANAMA

Arnulfo Arias, the newly-elected president of Panama (according to unofficial election results) is expected to pursue an initially cooperative attitude toward the US. Arias will probably support the defense-sites issue, at least until his government is recognized by other American republics and until his control of the Panamanian police is assured. Later, he can be expected to deny the reality of US special interests in the area and to pursue a nationalistic course in support of Panama's sovereignty.

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SECRET**A P P E N D I X****LIMITATIONS OF SOUTH CHINA AS AN ANTI-COMMUNIST BASE**

The deteriorating military situation of the Nationalist Army in North China and Manchuria has faced the Chinese National Government with the necessity of making plans for a future base of operations. South China (i.e. China, south of the Yangtze) is the only practicable area on the Asiatic mainland into which the Nationalists could withdraw. Both the assignment of T.V. Soong as governor of Kwangtung Province, with additional military and civil authority over much of South China, and the emphasis placed on the reconstruction of South China in the US aid program are evidences of the importance the National Government currently attaches to this region.

Although South China has many important natural resources and would, under normal circumstances, have access to the great rice producing areas in Hunan Province, seemingly insuperable obstacles stand in the way of developing the southern provinces into an economic and political bastion within the short time yet available to the National Government. With much of the agricultural surplus areas in Central China beyond the boundaries of stabilized Nationalist-controlled areas and with the demand for food increased by the presence of large Nationalist armies and millions of refugees, the food situation in the area will be precarious, even with imports from Southeast Asia. There is little manufacturing activity in the region now, and both Chinese and foreigners have been reluctant to invest any significant amount of capital in the region. Current mineral production is at a low level. Both time and capital will be needed to raise output significantly. Much time and a considerable amount of capital have already been dissipated by overly-ambitious Government planning. The current inflation throughout Nationalist China will

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seriously hamper the implementation of any plans for the region. The US aid program, which has many millions of dollars tentatively earmarked for South China, may be able to accomplish something in the way of limited reconstruction.

The political stability and the military security of South China are tenuous. Governor Soong has been hampered by intra-Kuomintang dissensions, as well as by Communist and dissident-Nationalist activity. The area might be defensible militarily, but the problems of evacuating troops from the north and supplying troops with the resources available to South China may jeopardize the military security of the region.

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44. Secretary, Joint Chiefs of Staff
- 45,46. Secretary of State
47. Deputy Director, Joint Intelligence Group, Joint Staff
- 48,49. Secretary, Joint Intelligence Group, Joint Staff
50. U.S. Air Force Representative on Joint Strategic Survey
Committee
- 51,52. Secretary, State-Army-Navy-Air Coordinating Committee

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